TAXATION OF PUBLIC FRANCHISES.

BY STATE-SENATOR JOHN FORD, AUTHOR OF THE FRANCHISE-TAX BILL.

As the first requisite to an intelligent comprehension of the public franchise tax law and the questions which it raises, one must have a clear conception of the distinction between a corporate franchise, which is simply the right to exist and do business as a corporation, enjoyed by all corporations alike, and the so-called public franchise, such as the right acquired to construct and operate a railroad in the public streets, which is a species of valuable property received from the community. This public franchise is held and enjoyed by every railroad and other transportation corporation using the public highways, in addition to its corporate franchise. The Appellate Division of the New York Supreme Court (15 App. Div., 585) clearly recognizes this "marked distinction between the franchise to construct and operate a railroad on a street, which franchise is absolute property, independent of the existence of the corporation and other corporate franchises, such as those of trading companies, which are merely to be a corporation and to do business." In the same volume (page 588), in another case in which a railroad company was plaintiff, it was held "that though the plaintiff had not laid a rail nor entered upon the street, its franchise was as absolutely property as the land abutting on the street." This is merely a reiteration of the doctrine clearly laid down by the New York Court of Appeals (111 N. Y., 1), which held that although the corporate franchise of a corporation holding a public franchise in the streets might become extinct through the dissolution of the corporation, the public franchise remained unimpaired as an asset, to be disposed of for the benefit of creditors, precisely like any other kind of property be-

longing to the corporation at the time of its dissolution. The new law affects this class of property alone, and has nothing to do with mere corporate franchises, whose value, when they have any value, is strictly analogous to that of the good will of an ordinary trading or manufacturing firm.

Since the decision of the Court of Appeals in *The People ex rel. Union Trust Company vs. Coleman* (126 N. Y., 448), rendered in 1891, franchises, both public and corporate, in the State of New York, have been absolutely exempt from local assessment, although they had previously borne some considerable share of the burden of taxation as personal property. The Tax Commission of New York City estimates that that municipality alone has lost, since the Union Trust Company decision, upwards of one hundred million dollars in taxes; for, although it concerned corporate franchises merely, yet the Court of Appeals in subsequent decisions extended the doctrine, and held that the public franchise of a street railroad corporation was likewise exempt from local taxation. Mr. Justice Cullen in an opinion unanimously concurred in (*People ex rel. Brooklyn R. R. Co. vs. Neff*, 19 App. Division, 590), rendered in 1897, remarks:

"This being the law, there should no longer be any attempt to avoid it or to tax property that is exempt. If the law is just, every one should favor it; if it be unjust, the only remedy is by application to the Legislature to alter it, for it is unquestionably within the power of the Legislature to subject this character of property to the same public burdens which other property within the State has to bear (*Henderson Bridge Co. vs. Kentucky*, 166 U. S., 150), a burden which for over forty years corporations have borne without cavil or complaint, and without suggestion that it was not imposed on them by law."

It was to alleviate the manifest injustice of the tax law to which the learned Justice called attention, that the bill to tax public franchises was introduced into the New York Legislature at its last session. How most effectively and simply to accomplish the purpose in mind, without disarranging the existing tax system or setting up new machinery, was a problem of no little complexity. It seemed clearly unjust to class corporate franchises, which can be had by the mere filing of certain papers in certain designated public offices upon the payment of an inconsiderable incorporation tax, by as many small groups of citizens as care to apply for them, and which have practically no value except that which is created for them by the enterprise, skill and experience of the incorporators, with the sort of franchises designated "public," whose value

is created exclusively by the community, and granted in most cases without compensation of any kind in perpetuity to the corporations enjoying them. A local tax upon corporate franchises generally will be justified only when a uniform tax is levied upon that other very important species of property known as good will, so that the concern carrying on, say, a dry goods business, as a partnership, will be subjected to the same burdens imposed on the competing concern doing its business as a corporation; for the corporate franchise of the latter has no element of value, of any consequence, not found in the good will of the former.

Nor did it seem fair that such franchises as those of steam railroad corporations, which purchase, improve and maintain, at their own expense every foot of land they use or occupy, and pay their full quota of local taxes upon it, in common with other property owners of every locality through which their roads pass, should be classified, for purposes of taxation, with the public franchises enjoyed by street railway corporations, for example, which come into possession of public property purchased, improved and maintained at enormous public expense, and exempted from taxation besides. The effort at improvement in the tax law was, therefore, directed exclusively to bringing the public franchise within the schedule of property taxable for State and local purposes.

Public franchises are easements in the street, of such a character as have been classified as real property since the dawn of the common law. Moreover, the New York courts, from the highest to the lowest, have repeatedly characterized them as belonging to that category. In the *People, etc., vs. O'Brien* (111 N. Y., 1), cited above, the Court of Appeals, in defining the character of the property which a railroad company owned in the public streets of New York City, had decided in 1888 that "the Broadway Surface Railroad Company took an estate in perpetuity in Broadway through its grant from the city, under the authority of the constitution and the act of the Legislature." "It is also well settled by authority in this State," the same decision adds, " that such a right constitutes property within the usual and common signification of that word." "The laws of this State," continues the court, "have made such interests taxable, inheritable, alienable, subject to levy and sale under execution, to condemnation under the exercise of the right of eminent domain, and invested them

with the attributes of property generally." Quite as explicitly another decision already quoted (15 App. Div., 588), held that the public franchise of the railroad corporation concerned in that case "was as absolutely property as the land abutting on the street." In the Mechanics' Lien law of New York, the term "real property" is defined as including, among other things, "the right or franchise granted by a municipal corporation for the use of the streets or public places thereof."

The question naturally arose, Why then is not this property taxed in common with other real estate, even though the Court of Appeals has held in the Union Trust Company case that it cannot be taxed as personalty? The answer was easily found. Although, under every one of the half-dozen or more definitions of the terms "land," real estate" and "real property" found in the various statutes of New York, public franchises of street railroads and transportation corporations would be included, they were carefully excluded from the special definition of those terms which was found in the tax law. "They are real estate for all other purposes," said the law in effect, "but not for purposes of taxation." And, as if to emphasize the inconsistency, the tax law definition actually included one kind of franchise as real estate, when, after enumerating as such "all wharves and piers," meaning the material structures, it added, "including the value of the right to collect wharfage, cranage or dockage thereon."

The definition then went on to name the kinds of property of railroads, telephone, gas and telegraph corporations and the like, mentioning the rails, substructures, superstructures, poles, wires, pipes underground and so on, but scrupulously avoided adding, as it did in the case of wharves and piers, "including the value of the right to collect toll from the public thereon." Thus was the most valuable and productive property in the community, which cost its owners nothing or next to nothing, exempted from taxation; and the burdens it ought to bear were thrown on other real estate, bought and paid for at its full market value by its owners, taxed regardless of its mortgage debt or its productiveness, and already burdened with the cost of purchasing, excavating, filling, bridging, regulating, grading and preparing the public streets for the corporations to which they were handed over for the mere asking. The public franchise tax law simply inserts about ten lines of new matter in the definition of real estate for purposes of taxation, so

as to bring the intangible public franchise, whose value in most cases represents from fifty to eighty per cent. of the total value of the assets of the corporation enjoying it, as well as the tangible structures, substructures and superstructures, within reach of the tax gatherer.

All the ingenuity of the opponents of the measure in both houses of the Legislature, and doubtless of the eminent counsel who appeared in opposition to it as well, was exhausted in a vain endeavor to devise some amendment that would cure its alleged "incompleteness" and "crudity." The fact is that it was so plain, simple and complete in itself that no rational amendment to it was possible. It makes no new law. It does not change the structure of the previously existing tax law in the slightest degree, but simply adds to the schedule of taxable real estate vast properties hitherto exempt. Whatever crudity or incompleteness there is about it is due, not to its own form, but rather to the general tax law under which it brings public franchises to be taxed precisely as other property of the same class is taxed. Nor is there a single valid reason why any new method of assessing or taxing these properties should be provided, which does not apply with equal force to all other real estate.

It is said that great opportunities for exercising favoritism, extorting campaign contributions, and discriminating between the different corporations affected, are afforded by the act, through the wide discretion enjoyed by local officials in assessing these franchises. All of that is literally true. But it is as literally true of the many times more valuable real estate already assessed throughout the State by the very same local officials. Every one knows that assessments are made now in an arbitrary and unscientific manner. The taxing power is, and always has been, used to a greater or less extent for political purposes, to reward friends and punish enemies of the respective local administrations, to extort campaign contributions, and even, in some instances, for the private gain of the public officials themselves. These things are inevitable under our tax law, as it stands; and every citizen in the State, whether he be the millionaire owner of a skyscraper on lower Broadway, a humble mechanic with a little home in the suburbs, or a struggling farmer, is subject to the hardships which they impose. Yet through all the years during which these conditions have existed, no eminent counsel appeared

before the legislative committees to plead for relief for the ordinary citizen from the cruel injustices done him through our absurd system. It was only when it was proposed to bring the untaxed property of the great corporations within the operation of the same law that the Capitol building began to swarm with eminent counsel, and the committee rooms to ring with their eloquent denunciations of the wicked attempt to tax the property of their clients as the property of other citizens is taxed. If the method of local assessment is bad for one class of real estate, it is equally bad for all other classes. If a special effort is to be made to ease the burden upon any class, the farm, the homestead, and the business block, ought in all justice to receive the first attention of the Legislature.

There will be less difficulty and uncertainty in assessing public franchises than in fixing the taxable value of almost any other kind of real estate, certainly so in the case of some kinds of real estate mentioned in the tax law. For example, there are "land under water," and "all trees and underwood growing upon land, and mines, minerals, quarries and fossils in and under the same." Then there is "the value of the right to collect wharfage, cranage, or dockage" on wharves and piers, an intangible kind of real property, and as truly a franchise as any brought into the law by the new act. It has been the business of the local assessor for years to assess all these things, with no rule or method of procedure prescribed in the law for his guidance. Yet he has managed to assess them all in some fashion, and to get some contribution to the public treasuries out of them, even though with him it may have been largely a matter of guess work. Were the public franchises to be assessed and taxed in the same way, they would at least bear some share of the public burden and their possessors would have no reasonable cause for complaint. But in the case of franchises of all kinds, there is a simple and unerring method of valuation, sanctioned by long usage in many states, and approved by the Supreme Court of the United States. It is to take the market or actual value of all the indebtedness, exclusive of debts for current expenses, and the market or actual value of all the stock of every kind issued, and the total will be the value of all the assets of the corporation. Deduct the actual or market value of all the tangible property in its possession, and there remains the value of the intangible property, or the franchise. This rule is recognized by

the laws of Connecticut, which, in taxing railroads, levy the same tax upon the market value of their debts as upon the market value of their stock. It is employed in assessing franchises in New Jersey, Indiana, Illinois and several other states. Its application in the valuation of public franchises under the new law in New York State will be even simpler than above indicated; for, since the franchise is to be taxed as real estate, it will not be necessary to separate the respective values of the tangible and intangible realty at all; but the actual value of the personal property only need be deducted from the total valuation of assets, as found under the rule, in order to discover the valuation of the taxable real property.

It would have been a simple matter to incorporate this method of assessment into the statute, but to have done so would have been unjust to the possessors of public franchises, because it would compel assessors everywhere to assess this property at full actual value, whereas it is well known that other property is, as a rule, assessed much lower and at widely different rates throughout the State. It seemed much wiser to follow the example of other States in which franchises are assessed and taxed locally, and leave the method of assessment to the discretion of the assessor as in the case of all other real estate. While corporate property should be made to bear its fair share of taxation, it should in no wise be discriminated against.

This precise method of valuing franchises, when first applied by the State Board of Equalization of Illinois to railroads, gave rise to three contesting actions, which were carried to the Supreme Court of the United States and there disposed of in a single decision in 1876 (*Taylor vs. Secor, Etc.*, 92 U. S., 575). Mr. Justice Miller, who wrote the opinion in the case, said:

"The statute of Illinois and the rule adopted by the Board of Equalization, under the power conferred by the clause we have just recited, may not be the wisest mode of doing complete justice in this difficult matter; but we confess we have, on the whole, seen no scheme which is better adapted to effect the purpose, so far as railroad corporations are concerned, of taxing at once all of their property, and of making the tax just and equal in all its relations to other taxable property of the State."

Again, after discussing in detail the rule as applied, the learned Justice continues:

"It is, therefore, obvious that, when you have ascertained the current cash value of the whole funded debt, and the current cash value of

the entire number of shares, you have, by the action of those who above all others can best estimate it, ascertained the true value of the road, all its property, its capital stock and its franchises; for these are all represented by the value of its bonded debt and of the shares of its capital stock."

No method fixed for the valuation of any species of real estate either by the courts or by the assessors, in the State of New York, is so simple, certain and easy of application as this. The great bulk of the properties reached by the act are publicly bought and sold daily, in the form of securities representing them. The stock market supplies continually an index of the value of all the principal franchises, while sales of other kinds of real estate are rare in comparison; and actual sales are the very best guides to actual values. There will be no trouble about equitably assessing franchises, except in the directors' rooms of the corporations owning them, and in the offices of their eminent counsel.

Some few important public franchises in the city of New York, and in other cities, are now paying some return to the cities in the form of a percentage of the gross receipts or otherwise. Some corporations pay considerable lump sums for their franchises when granted. All corporations holding public franchise pay a State franchise tax. It is therefore contended that the new law imposes double taxes upon them.

As to the franchise tax which they pay, that is a tax upon their corporate, not their public, franchises. A steam railroad, which paid for its roadbed at full market value, spent millions in preparing it for the ties and rails, and other millions in maintaining it, and which is taxed on every foot of the land it uses in connection with its right of way, pays a franchise tax to the State in addition. It is a tax on its right to be a corporation, and that is what the franchise tax paid by a street railroad corporation is, and nothing more nor less. The new tax on the street railroad will be, in effect, a tax on its roadbed—hitherto exempted—similar to that always paid by the steam road. As to the percentage of gross receipts paid to the city and the lump sums paid for the franchises, those constitute the consideration agreed to be paid by the grantees for the property they received. They are simply the purchase price. But because an ordinary citizen has bought and paid for his property and fully complied with his purchase contract, does the law therefore exempt him from taxation? He may have paid more than his property was worth, but he pays taxes

every year in addition. The possessors of public franchises have, for the most part, paid absolutely nothing for their properties, and never a tenth part of what they were worth. By what process of reasoning they bring themselves to believe that, because of the miserable little return they make to the city for their inestimably valuable easements in the streets, they are therefore entitled to exemption from taxation on them, is past finding out. Slight additional charges, such as car license fees, and the like, imposed on them, can hardly be classed as taxes at all, but in any event are so inconsiderable that they surely cannot be urged seriously as an equitable prohibition against State and local taxation.

What revenue will be realized from the act it is impossible to estimate with any degree of accuracy. That it will be very large is certain—far larger than even the corporations themselves realize. In general, it may be stated that the entire value of the stock of transportation corporations is the measure of the value of their respective franchises. The actual investment of capital is usually represented by the bonded indebtedness. When one considers the large number of companies, the value of whose shares will foot up from twenty-five to a hundred million dollars, one can form some idea of how much will be added to the assessed valuation of property throughout the State. On the other hand, the first effect of the law will be to depreciate the value of the stock, by reason of the prospective payment of a part of the profits of the company into the public treasury

The results of the operation of the law will be a revelation to the people, and a lesson they will not soon forget, in the art of utilizing these sources of revenue for the public advantage, instead of permitting them to be used exclusively for private gain. If the cities of New York were in possession of their own sources of municipal revenue, as fully as is Glasgow, they, like the Scotch city, would also be paying the entire cost of running their local governments without levying a cent of tax for that purpose upon the property of their inhabitants. And anyone who reads the signs of the times aright can not doubt that American municipalities will be content with nothing short of the realization of a similar condition of freedom from their present intolerable burdens of taxation.

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